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SIPDIS
SENSITIVE

TO WHA/FO CMC MULLEN, WHA/BSC MDRUCKER, BFRIEDMAN,
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TAGS: [ECON](#) [PREL](#) [EAGR](#) [EPSC](#) [PA](#)
SUBJECT: LUGO-LULA AGREEMENT ON ITAIPU

REF: A. ASUNCION 295
[1](#)B. ASUNCION 042

[1](#)1. (SBU) SUMMARY: After more than 10 months of negotiations, Paraguayan President Fernando Lugo and Brazilian President Ignacio Lula da Silva signed on July 25 a thirty-one point joint declaration on the bilateral Paraguay-Brazil hydroelectric dam Itaipu worth almost USD 800 million (about 8 percent of Paraguay's USD 10 billion GDP). Brazil agreed to increase Paraguay's compensation for Paraguay's share of ceded electricity, opened the possibility for Paraguay to sell electricity in the Brazilian market, and agreed to finance a five hundred kilovolt electricity transmission line from Itaipu to Asuncion. The joint declaration did not address two critical negotiation points for Paraguay -- Itaipu's debt and Paraguay's desire to sell its share of Itaipu's electricity to third countries. Considering Paraguay's reduced leverage in the negotiation process, the agreement is a meaningful political victory for Lugo (at least for now), and evidence of Lula's personal affinity for Lugo. END SUMMARY.

[1](#)2. (SBU) After more than 10 months of negotiations, Paraguayan President Lugo and Brazilian President Lula da Silva signed on July 25 a thirty-one point joint declaration on the bilateral Paraguay-Brazil hydroelectric dam Itaipu worth almost USD 800 million -- about 8 percent of Paraguay's USD 10 billion GDP. Paraguay will receive USD 360 million annually in compensation for excess electricity ceded to Brazil, a 200 percent increase from the USD 120 million Paraguay received when Lugo took office in August 2008. (NOTE: Paraguayan critics complain that Paraguay is still not adequately compensated. Paraguay's lead negotiator Ricardo Canese previously predicted that Paraguay could get at least USD 650 million from Brazil (reftel b). END NOTE).

[1](#)3. (SBU) Brazil opened the possibility for Paraguay to gradually sell electricity in the Brazilian open market. To make it operational, Brazil will need to modify a law that allows Paraguay's state-owned distribution company ANDE to sell electricity in Brazil through Brazil's state-owned ELECTROBRAS. Besides Itaipu's electricity, the Paraguay-Brazil agreement also enables Paraguay to sell electricity to Brazil from two smaller Paraguayan dams.

[1](#)4. (SBU) Construction of a 500 kilovolt electricity transmission line from Itaipu to Asuncion is also part of the agreement. Itaipu will finance the USD 550 million project at no cost to Paraguay. (NOTE: Despite being the most important electricity producer in the region, Paraguay suffers chronic electricity shortages and its few transmission lines are on the brink of collapsing. END NOTE).

[1](#)5. (SBU) The Brazil-Paraguay agreement failed to address two

of Paraguay's critical goals -- a restructuring of Itaipu's debt (USD 19 billion, half which is Paraguay's responsibility) and Paraguay's desire to commercialize its share of Itaipu's electricity with third countries (reftels a and b).

¶6. (SBU) Paraguay's lead Itaipu negotiator Ricardo Canese told Econoff late July 27 that Paraguay will continue to press its claims for debt restructuring and freedom to sell its share of electricity with third countries. He said that after Paraguay's Controller General completes its evaluation of Itaipu's debt, the restructuring process could begin. (NOTE: Paraguay's share of Itaipu's debt service payments exceeds USD 800 million per year, and almost half of it is questioned by Paraguay as illegal (reftel b)). According to Canese, the option to sell electricity in the Brazilian market helped balance Paraguay's demands for adequate compensation (just price) and freedom to commercialize. Canese said Paraguay's ability to sell its electricity in Brazil is a good start, but not the end of Paraguayan efforts to sell to third countries. He recognized that Paraguay's ANDE lacks experience to immediately commercialize electricity in Brazil, and it will take time before the company builds the necessary operational capacity.

¶7. (SBU) COMMENT: With the joint declaration, Lula deflected a sensitive issue with his next-door neighbor, enabling Lugo to deliver on one of his most significant campaign promises. This is clearly a big win politically for Lugo. But there is one major wild card: that both the Paraguayan and Brazilian congresses have to approve the deal. The Paraguayan congress should not present any serious objections, and Lugo said he would personally present the deal to Congress July 28. The worry here, however, is that the Brazilian Congress could render the agreement meaningless by voting against it. In any case, considering Paraguay's reduced leverage in the negotiation process, the agreement is a meaningful political victory for Lugo (for now), and clear evidence of Lula's personal affinity for Lugo. END COMMENT.
Shaker